Joseph P. Bort MetroCenter
101 Eighth Street
Oakland, CA 94607-4700
TEL 510.817.5700
TDD/TTY 510.817.5769
FAX 510.817.7848
E-MAIL info@mtc.ca.gov
WEB www.mtc.ca.gov

Memorandum

TO: BATA Oversight Committee DATE: April 7, 2010

FR: Executive Director

RE: Approval of Resolution No. 92 – Authorizing the 2010 BATA Project Financing Plan

Staff recommends approval of BATA Resolution No. 92 authorizing the various actions necessary to complete the issuance of up to $4.0 billion in toll revenue bonds for BATA projects. This authority will last for the balance of the 2010 calendar year.

Build America Bonds Program

The current state of the market combined with the success of the federal Build America Bonds (BAB) Program is offering BATA a unique opportunity essentially to complete its remaining project funding program in 2010 and at historically low interest costs. In early 2009, the traditional tax exempt financing market appeared to be stalled and confused. The combination of very limited market access and rising interest rates led to our initial 2009 strategy of a series of small bond issues to finance project funding needs. Market access changed with the approval of the BAB program by Congress in February 2009 as part of the economic stimulus legislation. The BAB program authorized State and local governments to issue federal government subsidized taxable bonds. Since tax-exempt rates are usually substantially lower than taxable rates, the federal government offsets the difference by providing a direct subsidy payment of 35% of the taxable interest rate to the bond issuer.

The BAB program offers traditional tax-exempt issuers access to an entirely new market with "net" interest costs that are very attractive. The tax-exempt market is highly specialized and only about 10% the size of the commercial taxable market. Because of the increased size of the taxable market, traditional tax-exempt issuers have access to a new market of investors, both domestic and foreign, such as pension funds and sovereign wealth funds. In addition to market access, the current low interest rate environment combined with increasing demand has made the "net" rate (the rate after federal subsidy) even lower than the comparable tax-exempt rate. BATA, for example, issued $1.3 billion of this taxable BAB debt in October 2009 at a taxable rate of 6.26% with a "net" interest rate of 4.07%. A comparable 40 year bond in the tax-exempt market would have been between 5.25% and 5.50%.

Issue:	$1.3 Billion
Term:	40 Years
Rate (Gross):	6.26%
"Net" Rate (65%):	4.07%
Tax Exempt:	5.25%

On a direct 40 year comparison, as shown above, the annual savings is $10 million, a present value over $200 million. The clear economic gain is a bonus we did not contemplate when planning to face the difficult tax-exempt market of 2009.

While the market access of the BAB program is expanding, the federal government has already announced plans to change the economics. Under current law, this highly successful program is due to sunset on December 31, 2010. The President's FY 2011 budget proposes legislation that will continue the program indefinitely but reduce the federal subsidy from its current 35% to 28% effective January 1, 2011. Other legislative proposals take a similar approach (the Senate bill reduces the subsidy to 30% by 2013). Whichever approach is taken, each 1% reduction in the subsidy will have the impact of adding approximately $1.8 million to annual debt costs ($72 million over 40 years) on a portfolio of $3.0 billion.

2010 Financing Plan

Staff believes there is an excellent opportunity to take advantage of the current market before the federal subsidy is likely to be reduced in January 2011. BATA still has a significant project commitment with over about $5 billion in project funding remaining:

▪ Bay Bridge East Span	$ 2.8 billion
▪ Dumbarton/Antioch Retrofits	.7 billion
▪ Regional Measure 2	1.0 billion
▪ AB 1171	.5 billion
▪ Total Project Commitments	$ 5.0 billion

Approximately 85% ($4.0 billion) of the remaining project commitments are scheduled to be completed over the next three years which is the allowable window under federal issuance rules relating to "arbitrage". As such, our target goal will be to complete the financing for up to $4.0 billion before the BAB program's 35% subsidy expires this year.

The 2010 strategy will be to take advantage of the market opportunities in both the taxable and tax-exempt markets. If the federal government continues to signal a reduction in the current 35% subsidy level, we should expect a late year rush to complete taxable financings under the current rate. As such, our plan will be to enter the taxable market before the year end rush. However, we believe the rush to complete taxable transactions may give us a window to secure attractive rates in the traditional tax-exempt market as well.

A major change in the 2010 issuance plan will be the proposed use of a "subordinate lien" structure. Subordinate lien simply means that the bonds issued prior to the 2010 bonds are technically paid ahead of these bonds (much the way a second mortgage is paid after the first). Both sets of bondholders, junior and senior, have equal rights to toll revenue and can compel toll increases in the event of a revenue shortfall.

Staff believes that this is a strategic time to utilize the subordinate lien. In light of the toll increases due to take effect in July 2010, our hope is to strengthen the coverage and ratings on the "senior" lien bonds providing some of the highest rated junior and senior lien transportation bonds in the country. For example, if BATA is able to upgrade its current Fitch and Moody's ratings to "AA" on a senior lien basis, we would expect the junior lien to be "AA-". Our senior lien Standard & Poor's rating already is "AA". Both ratings will be very strong and should be well received in both the taxable and tax-exempt world.

Risks

While completing the bulk of the remaining project financing in 2010 should have substantial economic advantages, there are risks associated with the strategy.

Arbitrage
Federal regulations require that bond proceeds be substantially spent within three years of a bond issue. Failure to meet these strict limits could result in the loss of tax-exempt status and repayment of the federal subsidy. BATA has generally avoided this issue in the past by issuing bonds that reimburse prior expenses. In this case, BATA will be issuing bonds based on the projected three-year cashflow. There are several ways to manage this risk in the event of project delay and a slowdown in expenditures, such as restricting the investment of bond proceeds to tax-exempt bonds.

Federal Subsidy
To the extent all or a large component of the 2010 financings are done as taxable BABs, BATA will be dependent on the federal government for regular large subsidy payments, as well as maintaining the 35% subsidy level for the forty year life of the bonds. For example, the annual subsidy payment on our 2009 BABs is $28 million. This dependence on the federal government creates a new risk to BATA that has not previously existed in the traditional fixed rate tax-exempt bond market.

Traditionally, the fixed rate bondholder assumes all of the risk of payment and issuer downgrade, as well as the risk that the federal government could repeal the tax exemption for interest earned on the bonds. In the taxable BAB Program, BATA, as the issuer, assumes the risk of continuing federal payments, as well as the risk that the federal government will not retroactively reduce the subsidy in the future or establish new conditions on future subsidy payments. If the federal government should fail to live up to its responsibilities, BATA could suffer serious financial consequences. From a market standpoint, however, both the banking and credit rating sectors have indicated their belief that the federal government will maintain the commitment. In addition, as the BAB market matures, the greater number of issuers should help build a stronger constituency to resist attempts to tinker with the federal subsidy.

Federal Set-off
The Internal Revenue Service and the U.S. Treasury have always maintained and utilized the power to set-off federal payments due against amounts owed to the federal government. We have already seen this situation develop on one BAB issuance which concerned the State of Florida enough to stop further BAB issues until they received reassurance from the Department of Treasury while the issue is of general concern, particularly for state issuers which do a large amount of business with the federal government, BATA has significantly less risk because BATA does not make payments to the federal government and only receives payments from the federal government in the case of the BAB subsidy and limited federal highway funds for the seismic retrofit program.

Market Saturation
There is also some concern that there is a limit to how large the investor appetite is for taxable municipal bonds. In 2009 the market absorbed over $70 billion in taxable municipal bonds and is expected to absorb over $150 billion in 2010. Further, the largest issuer will probably continue to be the State of California. This raises the issues both of overall market saturation as well as investors reaching internal limits on California issuers. Both situations could have the overall economic impact of limiting what BATA can issue as well as potentially increasing the overall cost. One mitigating factor is our strategy to utilize the traditional tax-exempt market as well for issuing debt in 2010.

Overall, staff believes the risks are manageable but exist nonetheless.

Resolution No. 92 authorizes the issuance of up to $4.0 billion in toll revenue bonds during 2010. The purpose of the bonds is to meet BATA project obligations over the next three years. Our goal will be to seek the most efficient financing at the best possible rates and, as such, the exact breakdown of taxable to tax-exempt debt will be market-based decisions at the time of the issuance. Specific terms and parameters of Resolution No. 92 include:

- 2010 issuance authority not-to-exceed $4.0 billion.
- Maximum taxable bonds rate of 8.50% (gross). (Net of subsidy = 5.53%)
- Maximum tax exempt rate of 5.53%
- Cost of issuance (taxable) not-to-exceed 2%
- Cost of issuance (tax-exempt) not-to-exceed 1.50%
- Subordinate lien structure
- Additional bonds test: 1.50x Senior / 1.20x Junior

If market conditions change and the parameters cannot be achieved, the transactions must terminate and be resubmitted to the Authority for further consideration.

As noted above, we are seeking a higher cost-of-issuance "cap" for the BAB debt. There are several reasons why issuance costs for taxable bonds are higher than tax-exempt. The primary reason is that the commercial desk receives a larger payment, or "takedown", to sell the bonds. Other issues include the relatively new nature of the taxable municipal product to the commercial buyer, and an initial reluctance by some buyers not to invest because the program may expire. The recent increase in order size and the number of investors submitting orders suggests that, as competition for the bonds increases, the takedown "gap" will begin to close.

<u>2010 Information Statement</u>
The Information Statement is the primary document used by the bankers and investors in the purchase of the bonds. The document describes BATA, our toll setting authority and the projects being financed.

<u>Supplemental # 1 to 2010 Information Statement</u>
The Supplement is used to tell investors of specific transaction details, including a description of the bonds, summary of the financing plan, security for payment of the bonds, and recent events that may be relevant to the bond holder.

<u>Trust Agreement</u>
The Trust Agreement is between BATA and Bank of New York as the trustee bank. The trustee bank process payments and acts on behalf of bondholders.

These documents combined constitute the issuance authority for us to $4.0 billion in 2010. If the bonds cannot be issued within the above parameters or cannot be sold during 2010, the authority to sell these bonds will lapse.

Staff recommends approval of Resolution No. 92.

Steve Heminger

SH:BM:cj